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DELEGATION OF THE COMMISSION OF THE EUROPEAN COMMUNITIES

March 16, 1981
HvM/mr

NOTE

441.2(103)
Special file

To: Mr. Roland de Kergorlay

From: Heinrich von Moltke

Subject: TRADE POLICY OUTLOOK IN US/EC RELATIONS

1. Whereas in 1980 the deficit in the overall trade balance of the U.S. has decreased slightly, that of the Community has increased considerably, in particular as a result of a greatly enlarged bilateral deficit with the U.S. On the basis of the latest figures for 1980, this deficit will have more than doubled that of 1979, i.e. over \$ 25 million. The major reason for this sharply increased deficit is a continuing of soaring imports of U.S. industrial goods and declining E.C. exports to the U.S.

The economic outlook for 1981 is bleak and the poor performance of the European economies in 1981 will probably not differ very much from the 1980 picture. The measures foreseen by the new economic policy of the Reagan Administration will certainly not have much effect before the second part of 1981, and their ultimate success is still open to questions. The latter is particularly true for the prediction that interest rates will come down sharply, although a declining tendency

has been observed recently. For the same reason it is difficult to make any forecast concerning the strength of the dollar on the currency exchange market. While a strong dollar would obviously decrease somewhat the export drive of the U.S. and would open new opportunities for European export industries on the U.S. market, it is still too early to say whether the tendency for our bilateral trade deficit with the U.S. to widen, will come to an end. The likelihood is that this deficit will remain at a very high if not increasing level.

2. So far protectionist pressures on both sides of the Atlantic have been kept under control. The record of U.S. trade policy decisions since the putting into effect of the MTN results is encouraging. The fact that the frequently announced recession has never really materialized in the U.S. has no doubt contributed to this. A failure of the Reagan economic plan to produce the much heralded turn around of the U.S. economy as far as its major long term weaknesses are concerned, could very soon alter the political climate dramatically and lead to a more protectionist climate. The bilateral EC/US trade relations could also be influenced by possible U.S. trade restrictions with regard to Japan due to the triangular nature of some of these trade problems.
3. The most obvious example of this is to be found in the automobile sector. The ITC decision that U.S. car imports from Japan are no substantial cause of material injury, has not closed the matter. Several bills for legislative quotas have been introduced in Congress, and there is no doubt that if it came to a vote, trade restrictions would find an overwhelming majority in both Houses of Congress.

Senator Danforth, Chairman of the Senate Finance Subcommittee on Trade, is nevertheless said to favor a VRA with the Japanese, and as sponsor of one of the bills, he is largely determining whether the question of legislative quotas will be up for a vote on the floor. In spite of a split in the Cabinet over this issue the likelihood is that some restraints will be requested from and accepted by the Japanese. Depending on the magnitude of such a restraint the Community might be forced into a similar attitude, and there is a danger that this might lead to Japanese retaliatory measures and thereby to an unraveling of the results of the MTN.

4. A similar danger exists in the field of steel. E.C. exports to the U.S. which were at 7.4 million tons in 1978 and 5.4 million tons in 1979, were down to 3.5 million tons in 1980. This downward trend can be expected to continue as long as the U.S. economy does not improve markedly indeed actual prices in our traditional markets in the U.S. are well below the trigger prices in effect in this area. The recently decided increase of 4.4. percent of the trigger price for the second quarter of 1981 can only make the situation worse. The price disadvantage faced by E.C. exporters together with recent changes in the parity of the dollar have increased the risk that some of them might undercut the trigger price in order to remain in the market. The U.S. steel industry which has a great stake in the maintenance of the TPM (it will indeed be able to recover about 92% of its outlays for new equipment, if the TPM remains in force until 1985) cannot be expected to stand idly while the trigger price would be eroded. The initiation

of antidumping and countervailing duty investigations could therefore again become a real threat and could be the source of serious tensions.

5. In the field of textiles, 1980 has witnessed a sharp increase in Community imports from the U.S. The Community had a net textile closing deficit of 300 million uce with the U.S. in 1979 which could rise to 500 million uce in 1978. Carpets, bedlinens and T-shirts/sweatshirts, remain problem areas, whereas the import surge for other items appears to be leveling off. There is still a real danger that particularly affected member countries like Great Britain, might have to ask for import relief which in turn could lead to retaliatory measures by the U.S. Administration.

In addition to these bilateral trade aspects, the imports surge of U.S. textile products in the Community has wider implications on the upcoming renegotiations of the MFA: it tends to make it more difficult for the Community to argue for continuing limitation of LDC exports into the Community.

6. Other pending sectoral trade problems which might still lead to considerable tensions:
 - Petrochemicals and synthetic fibers. Where subsisting price regulations for natural gas will continue to give U.S. industry an artificial cost advantage through lower feedstock prices.
 - Kraft. Where U.S. are pressing the E.C. for a speedy adoption of a new tariff definition and in the meantime complain about the customs treatment of U.S. shipments of saturating Kraft by Italian customs authorities.

7. In the field of export policy a likely area of tension exists in the area of export credits. The U.S. attempt to modify the OECD consensus in a way that would bring export credit terms closer to market conditions, has been thwarted until now by more restrictive proposals made by the Community. The budgetary policy of the Reagan Administration which includes sizeable reductions in Eximbank direct lending authority, could lead to a hardening of the U.S. attitude. Failing OECD agreement it cannot be excluded that the U.S. might resort in certain cases to countervailing duty proceedings. According to recent press reports an industry labor coalition presently contemplates the possibility of such complaints under Section 301 of the Trade Act of 1974. Furthermore it is virtually certain that failing such an agreement the U.S. will retaliate by granting long term export credits which E.C. countries will find difficult to compete with.

The unresolved problem of the tax exemption for U.S. exporting companies under the DISC system is likely to create difficulties.

8. In the field of export controls the U.S. can be expected to take a more rigid position in view of its tougher stance on East-West relationships. Presumably the U.S. will make a forceful attempt to obtain that Europe and Japan do likewise. Apart from Cocom, the Economic Summit meetings could be used as a framework for such policy coordination given the greater involvement of the E.C. countries in East-West trade, considerable difficulties can be foreseen in this field.

9. The above mentioned areas of friction are only the most obvious examples for possible US/EC tensions in the field of trade policy. Worsening economic conditions and a growing E.C. trade deficit with the U.S. could soon lead to other difficulties of this kind. In order to prevent these difficulties from having a serious impact on overall US/EC relationships, anticipatory action should be taken in the following fields:

- an effort should be made to identify possible areas of friction by trying to gather all available economic information and by listening to the advice of leading trade experts.
- an attempt should be made to persuade the embassies of the '10' to pool commercial information available to them through their consulates and other sources. In an effort to promote E.C. exports to the U.S. this attempt would have to be conducted in a very cautious manner in view of the existing competition between the industries of the member states.

March 13, 1981

MPC/fb

Concerning Trade Policy, an important fact is the very considerable trade deficit which the Community has with the U.S. (approx. \$25 billion in 1980). There are few indications about the development of the deficit during 1981; however, although it may be expected to decrease somewhat (notably due to the appreciation of the dollar), it will still remain very considerable. This does, of course, give us a considerable advantage whenever we have reasons to complain about U.S. policies. Nevertheless, there are limits to the effectiveness of the trade deficit argument, and political limits to accepting a deficit of this magnitude for a prolonged period.

Major problem areas in 1981 will presumably include the following:

- Steel: EC exports to the U.S. have decreased from 7.4 million tons in 1978 to 3.9 million tons in 1980. A further decrease may be expected in 1981, due to the fact that EC producers are being squeezed between the high U.S. trigger price, and the threat of antidumping and/or anti-subsidy complaints.
- Export Credits: The U.S., for budgetary and philosophical reasons, want to modify the OECD consensus to bring export credit terms closer to market conditions. The EC position is being blocked by France, where President Giscard d'Estaing has taken a personal hard line against any concession to the U.S. Unless the OECD talks show signs of succeeding towards this fall, it is virtually certain that the U.S. will retaliate by granting long-term export credits, where France is a competitor for a bid. In few cases, however, will France and the U.S. be the sole competitors, and other Member States may be affected.
- Export Controls: The Reagan Administration may be expected to strengthen controls on high technology (and perhaps even "ordinary" production technology) exports to the USSR, possibly tempered by a less restrictive attitude towards Eastern Europe and China. The U.S. will presumably, once its basic philosophy has been elaborated, make a forceful attempt in the COCOM framework to obtain that Europe and Japan do likewise. Unless Poland is invaded, it seems unlikely that all EC Member States will agree to a considerable strengthening of COCOM rules. This is likely to be a major area of friction.
- Petrochemicals: European complaints about artificially cheap U.S. feedstock encouraging a surge of U.S. petrochemical exports to the EC are liable to continue until the price of natural gas is deregulated in the U.S. (at the latest by 1985/87, possibly sooner if the Administration succeeds in persuading Congress to modify the natural gas Act. Pressures on the EC market may, however, be expected to decrease somewhat, due to the impact of the reevaluation of the dollar (which, of course, may not be a permanent phenomenon).

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What should the Community do in respect of these problem areas?

- Steel: There is no reason for the EC to accept a further decrease of its steel exports to the U.S., to the benefit of Korea and Brazil. The EC should insist on the maintenance of a reasonable market share, and it should be made clear to the U.S. that the EC will not accept a repetition of the 1980 antidumping complaints if the trigger price system collapses.
- Export Credits: The Commission is in the most unenviable position of being squeezed between the French and the U.S. Pressures may diminish if interest rates fall. However, a compromise is clearly necessary, leading at least to a reasonable increase in export credit interest rates.
- Export Controls: This is an area where the Community should, but does not, exercise its trade policy competence. The political consequences of the inevitable split between Member States when the U.S. start to apply pressure are very serious. The time seems ripe for an appropriate Commission initiative to bring this issue within the Community framework (where it belongs on the basis of Art. 113).
- Petrochemicals: The Commission should maintain its pressure on the U.S. to accelerate the decontrol of natural gas prices, not that one should expect any tangible results, but for reasons of maintaining the issue on the table.

In most of the areas mentioned above, the Commission, and consequently the Delegation, plays a role of firefighter and rarely, if ever, does it attempt to promote EC interests in a dynamic, forward looking fashion. This may be an inherent weakness of certain bureaucratic structures, but there is no reason why one should not attempt to remedy that weakness. At a time when the EC is running a trade deficit of \$25 billion with the U.S., our trade policy activities are, at the best, focused on protecting the status quo. The Member States, through their embassies, consulates, and Chambers of Commerce, do little more. There is a void between the noble generalities of trade policy (where our main activities lie) and the "nitty gritty" of trade promotion. This void could usefully be filled at the EC level.

In order to avoid conflicts of (perceived) competence it would seem necessary to start with a non-controversial initiative, which would not pit Member States against each other. One such area could be that of helping EC companies to take full advantage of the \$18 billion U.S. Government procurement market recently opened to foreign competition by the MTN Agreement. Tenders will be published regularly in the U.S., and in order to permit EC suppliers to submit their bids in time it would be most useful to devise a system permitting them to obtain detailed information on the tenders very rapidly. It should be possible to do so by using the Euronet system, through a data bank set up in Brussels, "fed" by a day-by-day input from a Washington terminal with up-to-date information. The cost of such a system would be minimal as compared with its potential benefits.

In the longer term, thought could be given to using the Euronet system for other trade and investment information on the U.S. market, providing a direct link between the Delegation and European exporters.

Mr P. Del

CH
March 16, 1981

M E M O

TO: Mr. de KERGORLAY

FROM: U. Knueppel

SUBJECT: 1. Trade Issues of Concern to the U.S.
in Agriculture and Fisheries.
2. Promotion of EC Agricultural Exports
to the U.S.

Trade issues of concern to the U.S.

As indicated in my memo of March 6, the main issues are:

1. Increasing EC subsidized grain exports in general, and to certain regions in particular (China, North Africa).
2. The U.S. fears that the EC may envisage a deconsolidation of the zero duty for grain substitutes and soybeans as well as soybean products, the possible introduction of a vegetable oil tax being considered as a first step in this direction.
3. The U.S. fears that citrus and almond exports to the EC may diminish considerably after the next enlargement.
4. The implementation of a hormone ban by the EC could bring U.S. meat exports to the EC (valued at more than 200 million dollars) to a halt. Poultry spinchilling is more of political than economic importance as a sufficiently large number of U.S. slaughter plants have already adapted to EC requirements.
5. Possible reduction of fish product exports following the envisaged introduction of a reference price system particularly for salmon.

Promotion of EC exports to the U.S.

1. The present situation as well as the outlook are rather discouraging. EC exports are stagnant at about 1.9 billion dollars annually and U.S. exports to the EC increased from 7.5 billion in 1979 to 9.3 billion in 1980, and is expected to reach 9.8 billion in 1981.

2. Major difficulties

EC surplus products are in surplus in the U.S. too, or their import to the U.S. is restricted because of EC subsidies (red meat, sugar). In other areas such as alcoholic beverages, competition from inside and outside the U.S. as well as changes in consumer tastes, make increased imports from the EC difficult. Quotas are imposed on most cheese imports and the threat of quotas exists for products such as tobacco and casein. For other subsidized products such as biscuits, etc., major expansion of imports is limited by the threat of countervailing duty or antidumping actions.

For more details, please see annex.

3. Recommendations

- a) Market research is important in order to find new products for export. If such research could be made in common, it would certainly be more efficient than individual Member State efforts. Chances would probably be best in the high price ranges (delicatessen) and in the development of product lines (more diversification of existing export items in the presentation as well as in the price ranges).
- b) Common product promotion by medias for products without a national image could be beneficial. For products with a national image (e.g. champagne, foie gras, etc.), a EC "label" could be rather damaging.
- c) Common promotion centers and common trade fairs in the U.S. would probably be an efficient measure to interest more wholesalers and retailers as they would find all EC products in one place. Although this would also increase competition between Member States, such common presentations should help to promote new or neglected products. The general question remains whether Member States would be ready to join in such efforts.

It should be kept in mind however, that local promotion centers should also be able to give some advice to those who wish to export to the EC since some trading firms are in both the import and export business.

ANNEX TO MEMO OF March 16, 1981

The following is the situation for major EC agricultural export items to the U.S.

1. Surplus products in the EC are also in surplus in the U.S. except for red meat and sugar.

EC red meat exports to the U.S. are at present limited by an exchange of letters, to 5,000 T annually because those meats are subsidized. Without export subsidies, we could not compete with Australia and others.

There are no EC sugar exports to the U.S. at the moment due to pending countervailing duty and antidumping cases, which may not be reviewed under the injury aspect in the near future. In addition, U.S. sugar imports in times of low prices, are restricted by a fee system and U.S. imports are decreasing due to the development of corn sweeteners.

2. EC exports have their greatest success in relatively expensive and sophisticated products.

a) Wines

Italy, France and Germany are the main exporters to the U.S. However, Italy and France are in heavy competition and Italy has the upperhand with rather inexpensive table and sparkling wines. In view of expanding U.S. production, the threat of protectionist legislation in several states (because of high imports from the EC and protectionist barriers in the EC vis a vis third country wines) and the trend towards inexpensive white wines, EC wine exports may soon reach their highest point.

German wines are at the moment somewhat discredited by a broadly published case of wine fraud.

b) Whiskey, Vodka, Gin, etc.

There is a trend away from whiskey to either wine or cocktails of white spirits. Such white spirits are cheaply produced also in Canada and other countries. Although EC exports have some advantage from the elimination of the wine gallon, the envisaged introduction of export restitutions may involve the EC in disputes with the U.S., and countervailing duty procedures with unclear outcome cannot be excluded.

c) Beer

Sales of EC products decreased recently because of competition from Canada, Mexico, etc.

d) Tobacco

There is a surplus on the American market and a permanent threat of the introduction of import quotas. In addition, surpluses in other third countries make competition rather difficult.

e) Cheeses

In two to three years at the latest, EC exports will reach their quota limit. Cheeses outside quota (soft ripened cheeses) are developing well but as soon as U.S. cheese producers start producing similar cheeses, we will have to face countervailing duty procedures because of our subsidies.

f) Canned Ham

We won a countervailing duty case, but exports should not be increased too quickly in order to avoid a new countervailing duty complaint. Due to heavy competition from Eastern European countries, considerable EC export increases could only be achieved through higher export subsidies.

g) Biscuits

We won a countervailing duty case, but the market potential for high quality biscuits (also subsidized) is limited.

h) Foie gras, Sausages

The market is limited because these products are rather expensive.

i) Casein

The market is rather stable. Although the EC is now the second exporter to the U.S. and has doubled its exports in the last two years, New Zealand and Australia remain important competitors. In addition, casein is also highly subsidized by the EC. There is a permanent threat of imposition of import quotas by Congressional legislation or by the Administration under Section 22 of the AAA of 1933.

March 11, 1981
JVR/aks

Subject: EC/US trade promotion

As a contribution to a note on this subject I would like to elaborate on some experiences drawn from EC/Canada economic cooperation.

Trade promotional activities, and other efforts towards closely related economic cooperation activities, have largely been a member states privilege, because of a restrictive interpretation of the notion of commercial policy (Article 113 Rome Treaty). Consequently, the EC Commission has had little occasion to build up both the experience and the mechanism necessary for action in this area.

The importance of the framework agreement on commercial and economic cooperation between the EC and Canada of 1976, lies in the precedent it sets for deviating from the old practice. Mixed feelings of member states about this change became apparent in a unanimous decision of the Council and the Member States of 20 September 1976, according to which practical measures of economic cooperation under the EC/Canada Joint Committee may not be initiated unless a common position has been agreed to beforehand under the Community's usual procedures. To my knowledge, this procedure has only been applied once (in the case of a Canadian energy saving technology).

Several years of intensive efforts to implement the EC/Canada agreement have basically shown three things:

- such efforts by the EC Commission only provoke interest with European industries as well as authorities and industries on the opposite side when member states or at least a large majority of them are not yet active in that particular area; it takes considerable work and particular creative capacities to identify such areas and initiate action.
- the Commission's efforts should largely concentrate on small and medium sized companies, who do not have the proper means to market their product or initiate joint ventures on another continent.
- the Commission's clout in the area of economic cooperation will automatically be the biggest in areas where the Community as such has a leverage. This applies in particular to areas where the EC has common rules or policies and where consequently negotiations with external partners are its exclusive responsibility (external trade, fisheries, nuclear supplies, etc.).

It is in this framework that it is easy to understand what have been the most successful activities under the EC/Canada agreement: a substantial number of business missions, largely consisting of representatives of medium sized companies often accompanied by bankers, have been organized in both directions, mostly in areas with a high technology content like: telecommunications, aeronautics, forestry products (in particular lumber for construction), non-ferrous metals, etc. The scope of such missions was mostly very large, covering possibilities for supplies, investments, technological cooperation, joint ventures, joint marketing in third countries, etc. They certainly scored some success at company level, but their results were hard to assess. Also missions were organized with the participation of representatives of power utilities and bankers in areas like Uranium and coal. At the Commission's initiative interest was developed with major European purchasers of natural gas in Arctic LNG projects as an alternative source of supply. Occasionally it happened that the Commission's assistance was required by a particular M.N.E (eg. sales promotion for the Airbus-300; also the case of an impasse in a major European investment project for fish processing in Canada).

Given the absence of adequate Commission mechanisms for the following-up of such promotional activities, the Commission's services sometimes ran into some kind of embarrassment.

However, Community-wise organized professional organizations and their Brussels lobbies were often helpful.

March 11, 1981
JVR/aks

Subject: Energy

The EC and US regularly consult on issues related to the world oil market, particularly in view of monitoring supplies of crude oil and oil products and controlling undesirable price developments on spot markets. Both sides have agreed with other nations on certain targets for consumption and imports of crude oil and participate in the establishment of international emergency systems in case of the threat of new supply crises.

The new Administration's position on this issue is not yet clear: it's philosophy is to rely on market forces to increase domestic production and decrease consumption; on the other hand it has announced a study concerning it's position vis-a-vis a possible broadening of IEA oil crisis mechanisms, which seems to imply its basic acceptance of such mechanisms.

In the absence of an all-round EC energy policy covering all the aspects of oil and natural gas supplies, the Community will only have limited negotiating possibilities on this issue.

March 11, 1981
JVR/aks

Subject: EURATOM/US nuclear cooperation

The former administration's nuclear non-proliferation policy was inspired by very strict concepts which showed up, a.o. in strong anti-fast breeder and anti-Plutonium attitudes. This materialized, a.o. in the unilateral US claim to modify the EURATOM/US agreement in the sense of introducing US prior consent rights on the reprocessing of US sourced material and on the use of Plutonium. A US Uranium embargo was in force against EURATOM for a short while in 1978, which, together with more restrictive conditions and more time-consuming procedures for US export and transfer licenses enhanced the European perception of diminished reliability of the US as a nuclear supplier.

The new administration seems eager to restore US credibility and consequently US influence on non-proliferation. More attention will likely go to efforts to increase multilateral (IAEA) and bilateral consensus on non-proliferation issues.

The prior consent claim will not disappear but the new priorities could lead the US to accept an extension of the legal status quo with EURATOM while being more flexible and expeditious in licensing procedures. Meanwhile the new administration will probably offer a settlement which would imply more predictable ways of exercising prior consent rights including the use of Plutonium in European reactors. It seems unlikely that Congressional opposition would kill such a solution.

EURATOM has never accepted the principle of renegotiating its agreement with the US before their final termination in 1995. It feels that the widely shared conclusions of the 1978-1980 INFCE conference justify the economic use and the safeguardability of European advanced reactor technologies. Even if EURATOM still depends on the US for an essential part of its nuclear supplies (in particular for highly enriched uranium) there was and still is strong opposition in the Council of Ministers to formally renegotiate the EURATOM/US agreement. It is not clear yet whether less formal and more pragmatic solutions will be acceptable to the Council.

March 13, 1981

CH

NOTE to Mr. de Kergorlay

Subject: Foreseeable difficulties with the new U.S. administration
Eventual new initiatives in the "science and technology" sector

A. Foreseeable difficulties with the new U.S. administration

- . In general R and D project expenditures will be cut in the near future. This will enhance the U.S. wish to collaborate internationally at the benefit of the U.S. science and technology community.
- . Spending in R and D projects in the field of nuclear energy, on the contrary, will not be cut; forbidden activities in the field of fuel reprocessing, plutonium recycle and Fast Breeder Reactor (plutonium economy), will most probably be allowed again. This will have a favorable effect to the development of nuclear energy in the U.S.A., but also throughout Europe. (The Carter policy has had a real depressive effect on the German nuclear industry in particular, but also to other European nuclear developments.)
- . International cooperation of the U.S. will mostly be materialized (from the U.S. side) in international forum (I.A.E.A., O.E.C.D., N.E.A., I.E.A.) or through bilateral agreements where it is easier for the U.S.A. to impose their wishes to their partners. Thus one may fear that U.S.-C.E.C. agreements will be more difficult to settle because the terms of exchange are generally less favorable to the U.S. (U.S. information is disseminated to all the member states and not only to one or two of them) than in bilateral agreements.
- . Some ways to enhance relations between the U.S. and the C.E.C. are given in appendix 1. Such measures are based on the premise that a body, somewhere within the Commission services in Brussels, is defining and monitoring the science and technology international policy.

B. Eventual new initiatives in the "science and technology" sector

Up until now, the science and technology section is working in a passive way in answering to demands coming from Brussels headquarters. Due to overburden, it has been completely impossible to envisage to take new initiatives.

The science and technology section could - if properly staffed - take a more active attitude in several fields.

- a. In the science field, an active attitude could be to prepare studies on the development of science in promising sectors. Such studies could be useful for decision making bodies in Brussels but also for the science counselors of the Ten. Such a service which could adapt its activities to requests of the Brussels services but also to the requests of the embassies of the ten. In establishing this service in this way, it could be the starting point for a Community science service among the Ten in Washington (see annex 2).
- b. In the field of technology, an active attitude could be to develop services for the technology oriented European Community industry. The science and technology section could examine if a common service

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here too could not be offered by the Delegation to the embassies of the Ten, (as an example, free access to computerized information on the European and U.S. technology markets).

Such an initiative could probably find its framework in the Commission action related to industrial innovation (annex 3).

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The ideas expressed in a and b hereabove - as any new ideas - need to be confronted with existing realities and have to be improved before being taken as real possibilities. One must remember here that it is much more difficult to build up an active attitude than to remain passive. I do suggest to proceed slowly, cautiously and progressively in assessing what could be an active role in the science and technology sector.

In any case, if such initiatives were to be envisaged, a clear reorientation of the science and technology section is needed in the direction of upgrading and properly staffing it.

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